FINANCING OF A POLISH LIMITED LIABILITY COMPANY

This paper concerns legal and tax aspects connected with the financing of a Polish limited liability company ("Company"). In particular we focus on the operations on the share capital, loans granted by shareholders and the rules of transfer pricing.

METHODS OF INTER-COMPANY FINANCING

Polish law generally requires transactions to be well documented, especially for tax purposes. Tax inspections can be very meticulous, particularly with regard to inter-corporate transactions. The arms-length principle is treated very seriously in Poland and from the point of view of the Polish tax law a "shareholder financing" is in no way different than a financing provided by a third party. Therefore, any payment received by a Polish Company from the shareholder must be documented as one of the transactions recognized by corporate law, i.e.:

1) capital increase,
2) loan,
3) so-called additional contributions – a special kind of shareholder financing governed by the Polish corporate law (see below),
4) payment for goods, services, licenses, etc.

Unless a payment from the shareholder to the Company can be documented to justify one of the above transactions, the tax authorities may require the Company to pay an income tax.

CAPITAL INCREASE

Increase of the share capital requires a prior resolution of the shareholders. Unless it has been foreseen in the Articles of Association, it also requires an amendment of the Articles, which needs to be documented by a notary public. Upon an increase of the share capital the company must file tax returns and pay a stamp duty amounting to 0.5% of the increase. The returns need to be filed (and the stamp duty paid) within 14 days of the resolution, otherwise the Company's Board members can be liable to fines, whereas the LLC would need to pay penalty interest in respect of tax arrears.

LOAN

Loans are a convenient instrument of inter-corporate financing, however, there are certain complications associated with accounting for such loans. First of all, loans must bear interest, otherwise the Company receiving the loan should recognize an income in respect of an extra benefit (free financing).

In case of intra-corporate transactions, transfer pricing rules apply, which rely on the arms-length principle. Under the transfer pricing legislation, in case a loan exceeds the value provided for by the CIT Act, the Company is bound to prepare local transfer pricing documentation the purpose of which is to prove the market nature of transactions with related entities. In case of loans, the main factor to be dealt with by the transfer pricing documentation is the interest, which needs to be coherent with the market reality. What is more, the tax authorities may require that each transaction between related entities, such as intra-corporate loans, be accompanied by the transfer pricing documentation.

Another aspect affecting loans are limitations in respect of the use of interest, commissions and collaterals as tax costs. The deductibility of such costs for tax purposes has been limited to 30% of EBITDA or PLN 3M (whichever is higher). Additionally, the CIT Act restricts deduction of costs of debt financing granted by a related entity to finance the Company's restructuring activities or acquisitions.

The good news is that loans granted by the shareholders are exempt from the stamp duty, which otherwise amounts to 0.5% of the loan.

ADDITIONAL CONTRIBUTIONS

The Articles of Association may provide for the shareholders' obligation – which arises under a resolution of the Shareholders' Meeting - to bring in so-called additional contributions, up to an amount defined by the Articles. Such additional contributions do not become part of the share capital and can be returned to the shareholders upon a relevant resolution of the Shareholders' Meeting, provided that certain requirements regarding the Company's financial situation are fulfilled.

Just like in the case of increase of the share capital, such contributions are subject to stamp duty of 0.5%.

TRANSFER PRICING

Although not a classic way of financing a company, high sales margins, license fees or high-yielding loans are popular instruments, often referred to collectively as transfer pricing tools, used to siphon off funds from subsidiaries. Tax authorities are well aware of these practices and are particularly sensitive to any transactions of sales, whether concerning goods, services or IP rights, made between related entities. Their focus is on the shifting of profit from one company to another through intercompany trade. If – according to the tax authorities - as a result of capital connections, the terms of trade that have been agreed or imposed vary substantially from those which would have been agreed between independent entities and, as a result, a given entity does not disclose any income or discloses an income that is smaller than might be expected in case such relations did not exist – the income of that entity and the tax due shall be assessed without taking into account the terms resulting from such connections. In such a case the income can be assessed by the tax authorities by way of estimation.

It is worth of note that upon an inspection tax authorities can demand the company to provide a transfer pricing documentation within 14 days. In case a transfer pricing documentation concerning a group of companies has been prepared in another language, the tax authority may request the submission of the group transfer pricing documentation in Polish within 30 days from the date of delivery of the request. If not provided, the difference between the income declared by the taxpayer and that determined by the authorities shall be subject to a penal tax rate.

CONCLUSIONS

Each case is different and therefore companies should always review many factors before opting for a particular financing strategy for their Polish subsidiary. International tax planning can further complicate the picture. No matter what the ultimate choice, it is always important to plan first, then carefully implement.

If you require advice regarding any matters concerning corporate project finance, you are welcome to contact the **authors of this paper:**

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